

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 92-271-C - ORDER NO. 93-218
MARCH 11, 1993

IN RE: Application of United Telephone Company of the Carolinas to Avail
Itself of Incentive Regulation.) ORDER GRANTING,
) IN PART, AND
) DENYING, IN PART,
) PETITION FOR
) REHEARING AND
) RECONSIDERATION

This matter is before the Public Service Commission of South Carolina (the Commission) on the Consumer Advocate for the State of South Carolina's (the Consumer Advocate's) Petition for Rehearing and Reconsideration (the Petition) of Order No. 92-1060. Order No. 92-1060, issued on January 29, 1993, granted United Telephone Company of the Carolina's (United's or the Company's) Application for approval to enter into an incentive regulation plan. After thorough review of the record in this proceeding, Order No. 92-1060, and the Petition, the Commission finds and concludes that the Petition should be granted in part and denied in part for the reasons set forth below.

1. The Consumer Advocate asserts that there has been no evidence introduced in either the Generic Proceeding¹ or the

1. Docket No. 90-266-C, Generic Proceeding to Consider Intrastate Incentive Regulation. The Commission's Orders from the Generic Proceeding docket are currently the subject of appeal by the Consumer Advocate.

present proceeding to support the impact of competition on the telecommunications industry. Therefore, the Consumer Advocate implies that the incentive method of regulation adopted by the Commission in the Generic Proceeding and approved for United in this docket is an improper method of utility regulation. In addition, the Consumer Advocate asserts that the Commission should have ordered that United be prohibited from pricing only competitive services, not all services, below its marginal costs.

In the Generic Proceeding docket the Commission found and stated that every local exchange company (LEC) is impacted by competition. Consequently, in the current proceeding, the Commission determined that in applying for incentive regulation United need not prove again the existence and impact of competition on its own operations. In Order No. 92-1060 the Commission specifically stated that "it is not necessary to quantify the level of competition or the loss of revenues. The Generic Proceeding determined the competition issue, and neither Order No. 90-849 nor Order No. 90-1009 required further showing by any LEC of the effects of competition." Order No. 90-1060, page 6. Thereafter, even though it found that United did not have the burden of establishing the presence of competition, the Commission determined that United had in fact shown the impact of competition on its operations. The Commission quoted extensively from Company witness Sokol's testimony and concluded that it had supplied sufficient evidence of competition.

The Commission concludes that whether or not there was

sufficient evidence of competition in the Generic Docket to support regulation under the incentive method is not an appropriate issue to be addressed in the current proceeding; that issue is the subject of the Consumer Advocate's pending appeal of the Commission's Orders in the Generic Docket. Further, the Commission finds that the substantial evidence of record from the current proceeding adequately supports its conclusion that United's operations are subject to pressure from competition. Accordingly, the Commission denies the Petition on these issues.

In addition, the Commission denies the Consumer Advocate's request that United be prohibited from pricing its competitive services below its marginal costs. At the hearing on this matter the Consumer Advocate's witness Buckalew testified that "no service should be priced below marginal costs." TR. Vol. 2, p. 115, lines 3-4. The Commission concludes that the issue raised now in the Consumer Advocate's Petition is not the same as its recommendation during the hearing. The Commission finds it inappropriate for the Consumer Advocate to raise the issue for the first time in its Petition. Therefore, the Commission denies the Petition on this issue.

2. The Consumer Advocate argues that the Commission erred by recognizing wage increases which occurred after the test year without making a corresponding adjustment to recognize a decreased pension expense and increased revenue due to additional customer growth through the same period of time. The Commission disagrees.

In Order No. 92-1060, the Commission approved the Company's

annualization of its after-the-test-year wage increases, including those made by the International Brotherhood of Electrical Workers (IBEW). This adjustment recognizes known and measurable changes to the salaries of employees who served United's customers during the test year. The Commission concludes it would be inappropriate and result in a mismatch of revenues and expenses if it updated the Company's revenues due to additional customer growth after the test period, as recommended by the Consumer Advocate, without also updating the increased employee levels after the test year.

The Consumer Advocate contends Order No. 91-1003, Docket No. 91-141-G (November 27, 1991),² supports its position that the Commission should update revenues to recognize customer growth after the test year. The Commission notes that Order No. 91-1003 does not support the Consumer Advocate's argument. In Order No. 91-1003 the Commission approved an adjustment to update the utility's plant in service to a period after the end of the test year. The Commission found that because the additional plant would be used to serve additional customers, it was appropriate to update the revenues from customer growth. In the current proceeding, the wage adjustment approved is directly related to the number of employees needed to serve the test year customers.

Further, the Commission concludes it would be inappropriate to adjust the Company's pension expense to reflect its estimated reduction in this expense after the test year. First, the

2. This Order was issued in a request for a rate increase submitted by Piedmont Natural Gas Company.

Commission finds that the 1992 pension expense is merely projected and not the actual expense based on an actuarial study as assumed by the Consumer Advocate. See, Hearing Exhibit 4. Therefore, the Commission concludes that the projected pension decreases do not meet the known and measurable standard.

Second, the Company's pension expense is based on employees at the end of the test year. If the Commission updated the Company's pension expense to an amount outside of the test period, then consistency would require updating employee levels and customer growth to a period outside of the test year as well.

3. The Consumer Advocate asserts the Commission's decision to approve United's accrual accounting treatment for its Post Retirement Benefits Other Than Pensions (OPEBs) is inappropriate for several reasons. First, the Consumer Advocate contends that of the \$1.2 million expense associated with the accrual method of accounting, only \$169,000 relates to the cost associated with current employees "and that the remaining \$999,000 relates to the temporary transitional obligation which is not attributable to the cost associated with current employees." Petition, p. 5. The Consumer Advocate claims that this evidence establishes that the accrual method does not match the cost of service rendered by United's employees with those ratepayers to whom the service is provided, as asserted by the Commission, and, instead, ratepayers will be paying the \$999,000 associated with former employees in their rates over an extended period of time.

The Commission stands by its conclusion in Order No. 92-1060

that the accrual method of accounting under SFAS NO. 106 matches the cost of service rendered by United's employees with those ratepayers to whom the service is provided. The Commission concludes that the Consumer Advocate misconstrues the costs represented by the temporary transitional obligation, \$999,000, associated with changing the accounting treatment for OPEBs from the "pay as you go method" to the accrual method. This transitional cost includes both the cost of retired employees and that amount necessary to recognize the cost of current employees which is unrecorded under the "pay as you go" method. While there may be some temporary mismatch of current ratepayers with retired employees, the Commission is not convinced there is any inequity during this interim period. As noted below, the Commission finds persuasive the evidence that, over time, the use of the "pay as you go" accounting method will result in higher costs for United's ratepayers. Furthermore, under the accrual method the OPEB cost associated with current employees will ultimately correspond with those subscribers who receive their service.

Second, the Consumer Advocate asserts the Commission erred by concluding the Consumer Advocate ignored the "necessity and effects of establishing a regulatory asset." Petition, page 6. The Commission disagrees.

The Commission is persuaded by the evidence of record that if United is forced to continue the "pay as you go" accounting method, and that if the difference between the "pay as you go" and accrual methods is established as a regulatory asset (as agreed to by

Consumer Advocate witness Miller), the recovery of such an asset will increase the cost of the "pay as you go" method, therefore resulting in increased cost to the ratepayers. The Commission finds United's testimony that the required establishment of a regulatory asset will ultimately result in greater cost to the ratepayer than that which will occur through the use of the accrual method convincing and finds no reason to alter its position on this issue.

Third, the Consumer Advocate argues that the Commission erred by not addressing its alternative proposal of using the accrual method of accounting for 1993 employees and continuing the use of "pay as you go" accounting for previous employees. The Commission disagrees. By approving the accrual method of accounting the Commission has inherently adopted the Consumer Advocate's alternative proposal as the accrual method will be used to report the OPEB costs associated with the 1993 employees. Additionally, the Commission has rejected the continued use of the "pay as you go" method.

Fourth, the Consumer Advocate contends the Commission "erred in comparing the OPEBs cost determined through an actuarial study with the pension cost also determined through an actuarial study." Petition, page 6. However, the Consumer Advocate states that it will withdraw its objection to the use of actuarial studies for the determination of OPEBs if the Commission requires United to update its OPEB's requirements each year in its annual review of incentive regulation with the most recent data.

The Commission has considered this request and finds it should

be granted. Therefore, United will be required to file its updated OPEB's requirements with its annual incentive reviews.

4. The Consumer Advocate contends the Commission erred in its finding of the appropriate level of cash working capital. The Consumer Advocate contends Hearing Exhibit 5 which it introduced to establish that the Company does not have a positive cash working capital requirement was not refuted by any other party to the proceeding. The Commission disagrees.

Hearing Exhibit 5 is a lead lag study of the Company's cash working capital requirement for the twelve months ending September 30, 1987. The Commission finds this study outdated. Furthermore, the Commission finds and concludes that no party of record presented a lead lag study of the test year under review. Finally, the Commission concludes that Staff witness Ellison's testimony that lead lag studies are not preferable to the approved 20-day formula method constitutes substantial evidence of record in support of its decision to approve the formula method for the calculation of cash working capital.

5. The Consumer Advocate contends the Commission erred by applying the balance sheet method to determine the cash working capital adjustment for United's directory operations. The Commission disagrees.

The Commission notes that Consumer Advocate witness Miller incorrectly asserted that the cash working capital allowance of \$679,085 was based on the balance sheet approach. The Commission did not adopt the use of any standard formula to determine United's

investment in its directory operations. Instead, the Commission included the level of United's prepaid expenses as contained in the Staff's report.³ Hearing Exhibit 10. The Commission found that these prepaid expenses were reasonable and that United should properly be allowed to earn a return on this investment. The Commission finds no reason to alter this decision and, therefore, denies the Petition on this issue.

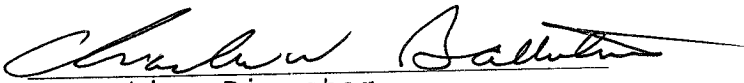
Conclusion

In summary, the Petition submitted by the Consumer Advocate is denied, except in regard to requiring the Company to annually file updated actuarial studies on its OPEB's requirements. United is hereby required to file updated actuarial studies along with its annual incentive regulation filings in accordance with the terms of this Order.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Executive Director
(SEAL)

3. This amount is less than the Company's actual prepaid expenses.